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ANALYSIS OF EFFECT OF INVESTMENT OPPORTUNITY SET, FREE CASH FLOW, CORPORATE GOVERNANCE AND FIRM SIZE ON DEBT POLICY

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ABSTRACT

The purpose of this study is to find empirical evidence of the influencing of investment opportunity set, free cash flow, corporate governance, and firm size on debt policy of Indonesian public listed companies. Based on the purposive sampling method, 52 observations were selected as a sample of this study.

This study found that investment opportunity set negatively influence debt policy. It means if the growth of company is high, the agency problem tends to be low, because the companies' free cash flow is low, and therefore, the control with debt policy was not needed. This study also found that corporate governance positively influence to debt policy. It means that the better corporate governance practice lead to increase debt because of easier to get funding supplier.

Keyword*: Investment opportunity set, free cash flow, corporate governance and debt policy.*

1. INTRODUCTION

Jensen and Meckling (1976) stated that conflict of interest between managers and owners or agency problems occurs when the manager and owner are different parties, or when managers do not control 100% stake. Agency problems tend to increase with decrease in the portion of shares owned by managers. Furthermore, Jensen and Meckling (1976) state that the manager hired by shareholders to manage the company with the objective to increase shareholder wealth. However, managers are more likely to make decisions and take action to maximize its interests are often not align with shareholder wealth.

Agency problems can be reduced in several ways including through the implementation of debt policy. The use of debt policy as a mechanism for reducing or controlling agency problems is influenced by several factors, such as the investment opportunities set, free cash flow, corporate governance mechanisms, and firm size. Investment opportunity set shows the company's growth opportunities. Growth companies tend to use more funding sources from their own capital or equity rather than debt. (Gul, 1999; Jaggi & Gul, 1999; Kallapur & Trombley, 2001; Jones & Sharma, 2001). In the context of Indonesians, Lestari (2004) found that the investment opportunities set negatively affect debt policy. It means that companies with high growth tend to have smaller levels of debt. While Puspitasari and Gumanti (2005) concluded that the investment opportunity set positively effect debt policy.

Other factors that also affect debt policy is the free cash flow. Jensen (1986) defines free cash flow as cash remaining after the enterprise fund all projects that generate positive net present value. Companies with excess free cash flow will have a better performance than other firms, because the company can make a profit on the various opportunities that may not be obtained any other company. Firms with high free cash flow are considered more survive in a bad situation.

Free cash flow theory predicts that increased amounts of debt will increase firm value because the agency costs related to free cash flow tends to decrease. This is a consequence of the ability of corporate debt policy to control the use of free cash flow in excess (Howton, Howton & Perfect, 1996). Jaggi and Gull (1999) found that free cash flow positive effect on debt policy for firms with low growth opportunities.

Good corporate governance (GCG) is also an important factor to be considered in the debt policy decisions. GCG is expected to serve as a tool to give confidence to investors that they would receive a return on the funds they have invested. Black, Jang and Kim (2003); Gillan, Hartzell and Starks (2003) and Harford (2005) found that the negative relationship between debt policy and quality of corporate governance. While Durnev and Kim (2003) actually found that the practice of corporate governance and disclosure have a positive influence on external financing. Hadrat and Pujiastuti (2007) also states that the quality of corporate governance had significantly positive impact on debt policy.

Company size is also a factor affecting corporate debt policy. Several studies provide evidence supporting a positive relationship between firm size and debt policy (Moh'd, Perry and Rimbey, 1998; Brigham and Gapenski, 1999; Soliha and Taswan, 2002). The relationship becomes stronger for larger firms than small firms with low growth opportunities (Jaggi & Gul, 1999).

This study aims to examine the effect of the investment opportunity set, free cash flow, corporate governance, and firm size on debt policy.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

2.1. Investment Opportunity Set and Debt Policy

Investment opportunity set (IOS) is an investment option in the future and reflects the growth in assets and equity. According to Gaver and Gaver (1993), IOS is the enterprise value the amount of which depends on the specified expenses of management in the future. IOS is also the investment choices that will hopefully generate a greater return. IOS can only be measured by using a proxy. According Kallapur and Trombley (2001), in general, proxies IOS can be classified into four types, namely:

1. Price –Based Proxy
2. Investment – Based Proxy
3. Variant – Based Proxy
4. Combination of individual proxy

Based on the proxies, we can determine the level of company growth. Jaggi and Gul (1999) found that firms with low growth rate would be more likely to increase debt. It is based on the premise that the company will utilize free cash flow available to invest in projects with positive net present value. Conversely Myers (1977) in Lestari (2004) states that companies with high growth rates are more likely to reduce the level of debt. It is based on the notion that increasing levels of corporate debt will be higher the likelihood the company was declared bankrupt by the debt holders if unable to pay debts. Furthermore, Myers (1977) states that companies with high growth rates are more likely not to add debt due to underinvestment and asset-substitution.

Underinvestment problem is the situation when a manager is more likely to invest in projects that have positive net present value. The problem arose because managers think that the debt holders is a party that has first claim on cash flows derived from the project. While the asset substitution problem occurs when managers are opportunistic replace the higher variance assets with lower variance assets, by increasing debt. Jaggi and Gul (1999) states that the investment opportunities set negatively affect debt policy.

$H_{1:}$ investment opportunities set negatively affect debt policy

2.2. Free Cash Flow and Debt Policy

Jensen (1986) defines free cash flow as cash remaining after all projects that generate positive net present value discounted at the relevant level of capital costs. Free cash flow is generally described as all cash generated by operations that can be distributed back to shareholders without affecting the current growth rate (Jokipii and Vahama, 2006).
Various conditions can affect the company's free cash flow value. If the company has a high free cash flow with low growth rates of free cash flow then this should be distributed to shareholders. If a firm has a high free cash flow and growth rates of free cash flow is high then this can be detained temporarily and can be used for investment in future periods.

Large free cash flow will lead to the manager's behavior is wrong and bad decisions, which are not for the benefit of shareholders. In other words, the managers have a tendency to use excess profits to consumption and opportunistic behavior of others because they receive the full benefits of these activities but they are less willing to take risk of costs incurred.

Debt policy can be used to control the use of free cash flow excessive by the manager. In addition shareholders will also enjoy more control over his management team for example, if a company issuing new debt and use the proceeds to repurchase common shares outstanding management is obliged to pay cash to cover this debt, simultaneously reducing the amount of cash flow available to management to be mocked. With the debt, management will work more efficiently in order to avoid financial failure so as to avoid a wasted investment (Jensen (1986).

Agarwal and Jayaraman (1994) in Jaggi and Gul (1999) states that companies with high free cash flow (FCF) and low set of investment opportunities will have higher levels of debt because the debt would reduce the agency problem associated with high FCF. Megginson (1997) in Mahadwarta (2002) states that dividend policy affects the debt with a positive relationship. Companies that distribute dividends in bulk require additional funds through debt to finance its investment.

$H_{2:}$ Free cash flow positively affect debt policy.

2.3. Corporate Governance and Debt Policy

The concept of corporate governance can be defined as a series of mechanisms to direct and control an enterprise that runs its operations in accordance with the expectations of the stakeholders. The concept of corporate governance developed along with the demands of the public who want a realization of the business life of a healthy, clean and responsible. This demand is actually a public response to the increasingly widespread cases of corporate irregularities around the world.

Forum for Corporate Governance in Indonesia (FCGI) defines corporate governance as "a set of rules that regulate relations between shareholders, management companies, lenders, governments, employees and stakeholders internal and external relating to the rights and obligations or in other words a system that controls the company ". The main purpose of corporate governance is to create added value for all interested parties or stakeholders (FCGI, 2003).

IICG defines corporate governance as processes and structures implemented in running the company with the primary objective increasing shareholder value over the long term by taking into account the interests of other stakeholders. Corporate governance problems can be traced from the development of agency theory that tries to explain how the parties involved in the company (managers, owners and creditors) will behave, because they basically have different interests.

IICG GCG conducted a survey of practices implemented by the company and resulted in a score of Corporate Governance Perception Index (CGPI). CGPI measures the extent to which companies meet the rules of corporate governance role in the implementation of the seven criteria: (a) the company's commitment to CG, (b) implementation of the GMS and its treatment of minority shareholders, including timely implementation of the GMS and the guarantee of protection of shareholder rights, (c) board of commissioners, its board of commissioners who are competent in their field and how optimal roles and responsibilities in the administration of CG, (d) the structure of the board of directors, its directors who are competent in their field as well as how roles and responsibilities of directors in the implementation of good corporate governance; (e) relations with *stakeholders*, how the relations and corporate responsibility with the parties associated with the company, (f) transparency and accountability, requires that any information that is open, timely, clear, comparable especially with regard to financial issues, management and ownership company; (f) in response to research IICG, the extent of the seriousness of the respondent to follow this research.

Implementation of Corporate Governance (CG) in a company brings many benefits. One of them according to FCGI, by performing the CG, some of the benefits to be had, among others:

1. Improve corporate performance through the creation process of making better decisions, improve operational efficiency and further enhance the company's services to stakeholders.

2. Facilitate obtaining a cheaper financing fund that ultimately enhances corporate value.
3. Restore investor confidence to invest in Indonesia.
4. Shareholders will be satisfied with the performance of the company as well as to enhance shareholder's value and dividends.

In addition to managing corporate funds from shareholders, the company also manages the fund manager of the bondholders or a creditor. Conflicts of interest between managers and the bondholder happened in terms of debt policy. This conflict arises when management took the projects that have a greater risk than predicted by the creditor. In this case the creditors are not harmed if funds would be invested in high-risk projects, because it will increase the risk of bankruptcy a company that will ultimately affect the value of a company with declining market value of debt or bonds that have not matured. Conversely, if high-risk projects that provide great results, the compensation received by creditors in the form of interest not rise. This shows that the debt can make the transfer of wealth from the bondholder to the shareholders that will be avoided by the bondholder.
Jensen and Meckling (1976) suggested using increased debt to reduce agency costs, although for different reasons, namely that outside equity is not increased so that the conflict between outside investors and the management did not increase. Chen and Steiner (1999) concluded that managerial ownership and debt policy has a negative relationship. This is due to factor substitution between the two. In addition, the high-risk conditions managers choose high-risk projects with the purpose of obtaining a high *return.* Risk reduction is done by using debt financing from lenders. However, the use of debt at high risk levels can reduce the agency costs of equity but can lead to agency costs of debt.

Black, Jang and Kim (2003); Gillan, Hartzell and Starks (2003) and Harford (2005) suggested a negative relationship between debt policy and quality of corporate governance. While Durnev and Kim (2003) it mentions the existence of positive relations firm selection will practice corporate governance and disclosure to the company's need for external financing. Hadrat and Pujiastuti (2007) also mentioned that the quality *of* corporate governance has a positive influence significantly the debt policy. This suggests that the better the quality of the implementation of corporate governance will further increase the debt policy.

Application of the better corporate governance makes companies increasingly trusted by the creditors, investors and other partners. Therefore, the funding originating from companies that debt will increase because the company has been trusted lenders so that access to funding sources of debt becomes easier. Although the proportion of corporate debt increases, shareholders will not be worried because the company that the application of corporate governance both will run the principle of transparency, accountability, responsibility, independence and fairness and equality. Principles are used to determine the value IICG Corporate Governance Perception Index (CGPI).

H $_{3:}$ index *of corporate governance* has a positive effect on debt policy.

2.4. Firm size and Debt Policy

According Sujianto (2001) firm size indicated by total assets, total sales, the average total sales and average total assets. In this case the sale is greater than the variable costs and fixed costs, you will get the amount of income before taxes. Conversely, if sales are smaller than the variable costs and fixed costs, the company will suffer losses.

In general, large enterprises are more diverse and tend to have low levels of bankruptcy or financial difficulties than small once, it makes them to have easier access to capital markets, particularly bond markets. Moreover, another important thing from a big company that is comprised of Assets-in-place, which allow them to publish a higher level of debt. Smaller companies are in a weak position to issue debt because of their ability to borrow is limited.

Numerous studies have showed evidences that company size affects corporate debt policy. The bigger the company the more the funds used to run the operating company and one of the source is debt. Large firms can easily access to capital markets. Ease of access to capital markets means the company has the flexibility and the ability to obtain funding.

Many studies claim that the company's debt policy is affected by the size of the company and said there was a positive relationship between firm sizes with the debt ratio. This shows that companies tend to increase its debts as they grow bigger. The study Moh'd, Perry and Rimbey (1998) found that firm size was positively related and significant effect on debt policy. The relationship becomes stronger for larger firms than small firms with low growth opportunities (Jaggi & Gul, 1999). In addition, Brigham and Gapenski (1999) in Soliha and Taswan (2002) also mentions that the company has high growth rates tend to require funding from external sources are great.

H_{4}: Firm size has a positive effect on debt *policy.*

3. RESEARCH METHOD

3.1. Operational Definition and Measurement of Variables

3.1.1. Investment Opportunity Set

Set of investment opportunities is an investment option in the future and reflects the growth in assets and equity. Set of investment opportunities can not be observed by an external party companies, so that the necessary proxies to measure it. Sharing of the investment opportunity set proxies have been used by researchers is based on the price proxy, proxy based on investment, proxy-based variant, or use a combination of proxy proxy individual.

This research uses a proxy-based pricing in measuring the investment opportunity set, ie Market to Book Value of Assets (MBVA). Size using a single set of proxy for investment opportunities based on the research Adam and Goyal (2006) which states that Market to Book Value of Assets to have better performance with the highest information content in assessing the investment opportunity set compared with proxy-proxy set of investment opportunities others. Market to Book Value of Assets (MBVA) is calculated by the following formula:

$$\mathbf{MBVA} = \frac{(\text{Total Aktiva}_{it} - \text{Total Equity}_{it}) + (\text{Shares Outstanding}_{it} \times \textit{Closing Price}_{it})}{\text{Total Aktiva}_{it}}$$

Where:

- *MBVA: Market to Book Value of Assets company*
- *Total assets: Total assets owned by company i in period t*
- *Total Equity: Total equity-owned company i in period t*
- *Shares Outstanding: Number of outstanding shares of company i in period t*
- *Closing Price: The closing price of shares of company i at the end of year t*

3.1.2. Free Cash Flow

Free cash flow is the company generated cash from operating activities that could be distributed to creditors or shareholders who are not used for working capital or investment in fixed assets. Free cash flow is measured using the formula Ross, *et al*

(2000) is to subtract the net cash flow from operating activities with net capital expenditures and working capital change divided by total assets. The amount of free cash flow ratio is then divided by total assets. The smaller the smaller the ratio indicates the company is free cash flow used to finance the company's assets. This size is intended to make it more comparable for the companies sampled, so the calculation of free cash flow to be relative to the size of the company (Rosdini, 2009).

Free cash flow is calculated by the following formula:

$$\mathbf{FCF_{it} = OCF_{it} - (Net\ Capital\ Expenditure_{it} + Change\ in\ working\ capital_{it})}$$

Where:

- OCF $_{it:}$ operating cash flow of company i in period t
- Net capital expenditure $_{it:}$ The end of the acquisition of fixed assets - the value of the initial acquisition of fixed assets the company i in period t
- $_{It}$ Working Capital: The total value of assets - total value of liabilities of the company i in period t
- Changes in working capital $_{it:}$ working capital year-end - start-up capital of company i in period t

3.1.3. Corporate Governance

Corporate governance can be measured by the size of the board of directors and board of commissioners, the independence of the commissioner, the turnover of directors and corporate ownership structure. In addition, corporate governance can also be measured by an index or ranking peruasahaan implementing corporate governance (Hadrat and Pujiastuti, 2006). In this study, a measure for corporate governance using an index of corporate governance a rating of the application of corporate governance in companies, conducted by independent research institute IICG (The Indonesian Institute for Corporate Governance) and published by Self magazine Sembada. Each item question asked by IICG have a scale from 0 (lowest quality of its corporate governance) to 100 (highest quality of its corporate governance), so that the corporate governance index is grouped into three title companies are very reliable (score value 85 -100), reliable (score of 70 to 84.99 value) and fairly reliable (score value of 55 to 69.99).

3.1.4. Firm Size

Firm size can be expressed in total assets, sales and market capitalization. The larger total assets, sales and market capitalization, the greater the size of the company. In this study measured firm size using total assets. Firm size is calculated by the following formula:

$$\boldsymbol{FIRM\ SIZE_{it}} = \mathbf{Ln\ Total\ Aktiva_{it}}$$

Where:

Ln Total Assets $_{it:}$ Natural logarithm of total assets owned by company i in period t

3.1.5. Debt Policy

Measurement of variable debt policy is to use the debt ratio. This size is chosen based on research Jensen, Solberg and Zorn (1992) which states that the debt ratio emphasizes the importance of debt financing by showing the percentage of assets backed by debt.

The data for the policy variable debt is calculated by the following formula:

$$\mathbf{Debt\ Ratioi_{it}} = \frac{\mathbf{Total\ Debt_{it}}}{\mathbf{Total\ Aktiva_{it}}}$$

Where:
Debt Ratio (DR): The ratio of debt the company i in period t
Total Debt : Total debt firm i in period t
Total Assets Total assets owned by company i in period t

3.2. Population and Sample

The population in this study are all companies listed on the Indonesia Stock Exchange in 2006-2008. Selection of the sample in this study using purposive sampling method with the sampling criteria used are as follows:

1. Companies listed on the Indonesia Stock Exchange included in the rating CGPI in 2006-2008, published by Self magazine Sembada.
2. Companies included in the ranking CGPI publish financial statements for the year study period from 2006 to 2008.

If during the observation period, the company only entered the ranking CGPI for one year only, then the company is still included in the study sample (pooling data). Based on the above criteria, then the obtained sample of 27 firms by the number of observations of 52 observations.

4. RESULTS AND DISCUSSION

4.1. Descriptive Statistics

Descriptive statistics are part of the data analysis provide the initial gamabaran variables used in the study. Descriptive variables used in this study is the average *(mean),* maximum, minimum, and standard deviation of each variable. Dependent variables used in this study are presented with debt debt and the independent variables used are the investment opportunity set (IOS), free cash flow (FCF), corporate governance (CG) and firm size (SIZE).

Table 1
Descriptive Statistics

Variable	Mean	Maximum	Minimum	Standard Deviation
Debt	0.5771	0.91	0.21	0.23407
IOS	1.6719	7.33	0.63	1.10335
FCF	- 0.0468	0.33	-0.66	0.17955
CG	76.9794	89.86	56.38	8.03782
SIZE	29.6907	33.51	22.41	2.13006

Sources: Secondary data is processed, 2010

From table 1 for the entire sample can be seen that of 52 observations, obtained an average value and standard deviation for the policy of debt are 0.5771 and 0.23407. Standard deviation values lower than the average value indicates that the policy of the company's debt is relatively the same study. The maximum value of 0.91 indicates the ratio of the company's largest debt and a minimum value of 0.21 which indicates the ratio of the company's smallest debt.

Variable Investment Opportunity Set (IOS) is a proxy used to measure the level of corporate growth opportunities. Opportunity to grow the company can be seen from the investment opportunity. In this study, the investment opportunity set proxy used is the Market to Book Value of Assets (MBVA). IOS proxy has the average value and standard deviation of 1.6719 and 1.10335. These results indicate that the company be sampled in this study are not too many investments and investments that do not vary. It can be seen from the comparison of the value of standard deviation and the average of less than 1 that is equal to 1.10335 (1.6719). The maximum value of 7.33 indicates the ratio of the largest investment by the company and the minimum value of 0.63 indicates the ratio of the smallest investments made by company.

The variables are free cash flow (FCF) is cash issued by companies to finance projects that have a positive NPV is not used for working capital or investment in fixed assets. This variable has an average value of -0.0468 and a standard deviation of 0.17955. Standard deviation values greater than the average value indicates that the free cash flow became a research company that is highly variable and save the company more than investing the proceeds in projects profitable and has a positive NPV. The maximum and minimum values indicate that the FCF-owned companies with the largest number of 0.33 and the smallest number is -0.66. Positive direction at the maximum value of FCF indicates that the company's operating cash flow is greater than the sum of net capital pegeluaran and changes in working capital, negative direction contrary to the minimum value of FCF indicates that operating cash flow of the company's lower than the amount of net capital expenditures and changes in capital company's work. The maximum and minimum values indicate a significant difference in the amount of FCF stored by the company that became the study sample.

Variable application score Corporate Governance (CG) sample firms have an average of 76.9794% with a minimum value of 56.38% and 89.86% of its maximum value. This suggests that the quality of the application of corporate governance and the lowest was 56.38% the highest quality implementation of corporate governance is 89.86%.
The variable firm size (SIZE) measured by the natural logarithm of total assets showed an average value of 29.6907, the value of standard deviation of 2.13006 and a maximum value (minimum) of 33.1 (22.41). This shows that the smallest companies had total assets of 22.41 and the largest company has total assets of 33.1.

4.2. Univariate analysis

The analysis was conducted to see the influence of independent variables and the dependent variable individually by first grouping the sample into two groups: companies that have high IOS and IOS low, companies have free cash flow negative and positive, the company that the application of corporate governancenya quite reliable and very reliable, and small and large companies. This is done to see if there is a difference between corporate debt policies that have a high IOS and IOS low, debt policies among companies with free cash flow of negative and positive, between the company's debt policy with a CG that is quite reliable and very reliable, as well as between corporate debt policy large and small and can be seen by the table below:

Table 2

The results of univariate descriptive analysis

Dependent Variables	Independent Variables	Category	N	Mean	Standard Deviation	t-test
Debt	IOSCAT	Low	33	0.6694	0.22770	4.361 ***
		High	19	0.4167	0.14243	
Debt	FCF	Negative	23	0.5295	0.18146	-1316
		Positive	29	0.6149	0.26567	
Debt	CG	Quite Reliable	19	0.4793	0.16789	-2.539 **
		Very Reliable	33	0.6366	0.2478	
Debt	SIZE	Small	27	0.4866	0.20117	-3.140 ***
		Large	25	0.6749	0.23110	

Sources: Secondary data is processed, 2010
**** Significant at 1% level*
*** Significant at 5% level*

From table 2 we can see that debt policy for the group of companies that have high IOS and IOS have low average value of debt for high-IOS is 0.4167 and the standard deviation of 0.14243, while the average debt for low IOS is 0 , 6694 and the standard deviation of 0.22770. This indicates that companies with low growth rates use more debt than companies that have high growth rates.

Variables that have the company's debt to free cash flow (FCF) has a negative average value and standard deviation of 0.5295 and 0.18146, while the average value and standard deviation for positive free cash flow amounted to 0.6149 and 0 , 26 567, which means showing that companies that have a positive FCF more use of debt from negative FCF It is intended to reduce the agency problem because of the presence of debt can be used to control the use of excessive free cash flow by the manager.

The variable debt to companies with the implementation of Corporate Governance (CG) is quite reliable to have the average value and standard deviation of 0.4739 and 0.16789, while the average value and standard deviation for the implementation of highly reliable CG amounted 0.6366 and 0.24798. These results indicate that the level of corporate debt by applying very reliable corporate governance is higher than companies with the implementation of corporate governance is quite reliable. Application of the better corporate governance makes companies increasingly trusted by the creditors, investors and other partners. Therefore, the funding originating from companies that debt will increase because the company has been trusted lenders so that access to funding sources of debt becomes easier.

Variable debt for small firms has a mean value and standard deviation of 0.4866 and 0.20117, while the average value and standard deviation for large firms is 0.6749 and 0.23110. These results indicate that large firms have higher debt levels than small firms because large firms require more funds to the company's operations.

4.3 Hypothesis Testing and Discussion

After testing the classical assumptions, it can be concluded that the data is eligible to proceed to a regression model that can be used to test the research hypothesis. Table 3 shows that the set of investment opportunities and the negative effect is statistically significant impact on debt policy. This shows if the company has set a high investment opportunity the company tend to have lower debt levels. These results support the opinion of Myers (1977), which states that companies that grow are more likely to reduce debt levels, associated with underinvestment and asset substitution problem. Related to the underinvestment problem, managers are more likely not to invest in projects that have positive NPV, because the cash flow from the project is first claimed by creditors. Substitutions in connection with the problem assets, increase in debt means that some company assets will be used as collateral for the debt. In addition to these two problems, Myers (1997) stated that the company grew to reduce its debt level to minimize the possibility of claims by creditors if the company could not pay the debt.

Table 3
Multiple Linear Regression Test Results

Independent Variables	Regression Coefficient	t_{count}	Significance
IOS	-0.101	-2.584	0.013 **
FCF	-0.149	-1.222	0.228
CG	0.007	2.266	0.028 **
SIZE	0.010	0.773	0.444
Constant = -0165 F_{count} = 4275 Sig F_{count} = 0.005			

*** Significant at 5% level*

The results of this analysis support the statement of Myers (1977) and Holydia (2004) which states that the set of investment opportunities negatively affect debt policy. Set chance invetasi negative effect indicates that the company's high growth opportunities will be mainly financed with equity capital for investment in more profitable company and shareholders tend to want to enjoy these benefits themselves, so that investment financed by capital rather than the debt itself. These results contradict the findings Puspitasari and Gumanti (2005) which states that the debt policy sets a positive effect on investment opportunities in the final expansion stage, mature and decline the company, which means the level of corporate debt will increase if the investment opportunity set high because the company needs additional funds to make these investments.

Table 3 also shows that free cash flow of no significant impact on debt policy and its influence is negative. This indicates that companies with high FCF is more likely to use these funds for consumption purposes and the purposes of opportunistic corporate managers rather than using those funds for investment. So free cash flow in the study can not be proven as a controller of agency problems.

The results of this study is not relevant to the research Agarwal and Jayaraman (1994) and Jaggi and Gull (1999) which states that free cash flow and have significant influence toward a positive relationship with the lending policies to large companies with low growth opportunities, which means the level of debt companies with low growth is high when a high free cash flow.
In addition the study found that corporate governance is a significant positive effect on debt policy .. These results indicate that the better the quality of the implementation of corporate governance makes companies increasingly trusted by the creditors, investors and other partners. Therefore, the funding originating from companies that debt will increase because the company has been trusted lenders so that access to funding sources of debt becomes easier. From the perspective of shareholders, although the proportion of corporate debt to increase, they will not worry because the company that the application of corporate governance both will run the principle of transparency, akuntanbilitas, responsibility, independence and fairness and equality. So that corporate governance can be proved as a controller of the agency problem because the application of corporate governance that better indicate the agency problem is low.

The results of this analysis is consistent with research Durnev and Kim (2003), Hadrat and Pujiastuti (2007) which states that the quality of corporate governance has a positive influence significantly the debt policy. These results are inconsistent with the Black, Jang and Kim (2003), Gillan, Hartzell and Starks (2003) and Harford (2005) mentions the existence of a negative relationship between debt policy and quality of corporate governance.

But the study did not find that company size has a positive effect on debt policy. Although no significant effect, but firm size has a positive relationship with the debt policy. This indicates that the larger the size of a company will mark more and more funds needed to fund the company's business activities and one source is the increase in debt. Increasing debt is one mechanism that can control the agency problem because large companies have a higher agency problems of small companies. The results of this study are consistent with the results of the study Moh'd, Perry and Rimbey (1998), Jaggi & Gul (1999), Brigham and Gapenski (1999) in Soliha and Taswan (2002) which states that firm size has a positive effect on debt policy.

4.4. Goodness of Fit Model Test

F test used to determine whether the model used in the regression has been fit (goodness of fit model). Based on the results of data processing, obtained F value $_{\text{calculated}}$ for 4275 and a significance value of 0.005. F value $_{\text{table}}$ for k = 4 n = 52 is 2.550. $_{\text{Calculated}}$ F value is greater than $_{\text{the table}}$ F value and significance smaller than 0.05 indicates that the regression model created an appropriate regression model, so it can be applied to a population with an error rate of 5%.

The value of the coefficient of determination can be seen on multiple linear regression test calculations in the table R Square. Based on the results of data processing, obtained the value of Adjusted R Square of 0.208 or 20.8%. This means that the influence of independent variables is the set of investment opportunities, free cash flow, corporate governance and firm size on debt policy (the dependent variable) only amounted to 20.8% while the remaining 79.2% (100% - 20.8%) influenced by other variables outside the model study. Adjusted R Square value of 20.8% showed a low influence of independent variables on the dependent variable in the model because this study more than half is affected by other variables. Adjusted R Square of low value due to the existence of two independent variables are not significant free cash flow and company size.

5. CONCLUSION, IMPLICATIONS, LIMITATION, AND SUGGESTIONS

5.1 Conclusion

The company is seen as a set of contracts between corporate managers and shareholders. The appointment of managers by shareholders to manage the company in fact often encounter problems due to company goals clashed with the manager's personal goals. With the competencies of managers can act with the only benefit himself and sacrificing the interests of shareholders. This is called the problem of agency *(agency problem)* and the debt policy is a mechanism that can be used to reduce or control the agency problems. This research was conducted with the aim to obtain empirical evidence regarding the effect of the investment opportunity set, free cash flow, *corporate governance* and firm size on debt policy. This study used a sample of companies listed on the Indonesia Stock Exchange and follows the rankings CGPI dlakukan by IICG and published by Self magazine Sembada the study period from 2006 to 2008.

Based on the analysis and discussion in the previous chapter, then obtained the following conclusion:

1. The results showed that the investment opportunity set of a significant negative impact on debt policy, it indicates that the higher the investment opportunity set, the lower the level of debt a company has, since the company more growth opportunities financed by equity rather than debt capital.
2. This study did not find that free cash flow effect on debt policy. Free cash flow which has a negative direction indicate that the company has a high free cash flow will have lower debt levels. This indicates that companies with high free cash flow is more

likely to use these funds for consumption purposes and the purposes of opportunistic corporate managers rather than using those funds for investment activities.
3. This study also found that corporate governance is a significant positive effect on debt policy This suggests that the better the quality of the implementation of corporate governance makes companies increasingly trusted by the creditors, investors and other partners. Therefore, the funding originating from companies that debt will increase because the company has been trusted lenders so that access to funding sources of debt becomes easier.
4. However, this study found no effect of firm size on debt policy

5.2 Implications of Research Findings
1. For companies, in making the optimal debt policy considerations influenced the company's growth opportunities and corporate governance. If the company has a high chance perumbuhan the growth opportunities are more financed with equity capital because of high profits with low risk and the benefits tend to be enjoyed by the shareholders. If the company's corporate governance is better then the company tends to increase the debt because it is easier to access funds from debt sources.
2. For potential investors, by knowing the rate of growth of a company whether high or low, investors may decide to investing or not. If the high growth opportunity, the investor can invest in companies the benefits are likely to be high with low risk and benefits can be enjoyed by investors.
3. For creditors, in order to consider the application of corporate governance prior to giving loan to the company, ie whether the application of the company's corporate governance can be trusted or not. If the company can be trusted then the lender can give you a loan because the company will not be detrimental to creditors.
4. Strengthen the results of previous research which states that the set of investment opportunities negatively affect the debt policy and corporate governance have a positive effect of debt policy.

5.3 Limitations of Research
1. This study did not include data for the period of observation in 2009.
2. This study only measures the investment opportunity set by proxy Market to Book Value of Assets (MBVA).
3. Free cash flow is only measured in one way only so that in the study of free cash flow becomes insignificant, and free cash flow is only grouped into positive and negative.
4. Firm size is measured only in one way only so that firm size is insignificant in this study.
5. R^2 values are low in this study demonstrate the ability of the independent variables in explaining the dependent variable is limited.

5.4 Suggestions for Further Research
1. Future studies are expected to extend the observation period because of corporate governance index data for 2009 already exist. Researchers can not enter data in 2009 because of financial reporting data for 2009 can not be accessed.
2. Future studies could measure the set of investment opportunities with other proxies such as proxied by price, proxies and proxy based on investments based on the variant, and based on a combined proxy. It also connects the set of investment opportunities with enterprise life cycle.
3. Future studies could measure the free cash flow by using other means such as means used by Jaggi and Gull (1999) and free cash flow can be classified into high and low, low free cash flow is below average and above average height.
4. Future studies can measure firm size by using other means such as those used by Andriyani (2006) is by using the size of the total sales.
5. Future studies may add a new independent variables that could affect the dependent variable (policy loans) as dividend payout ratio and the share ownership structure.

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